Nos. 82-1453 and 82-1509

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

ERNEST BADARACCO, SR., *et al.*, *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

DELEET MERCHANDISING CORP., *Petitioner,*

v.

UNITED STATES OF AMERICA, *Respondent.*

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY BRIEF FOR PETITIONER, DELEET MERCHANDISING CORP.

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Question Presented

Does the subsequent filing of a complete and honest amended return start the running of the statute of limitations provided in Section 6501(a) as Petitioner contends, or does the filing of an allegedly fraudulent return give the Government the right in perpetuity to assess deficiencies and penalties—no matter what remedial steps are taken by the taxpayer—as the Government contends?

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POINT I

Subsection 6501(c)(1) and Subsection 6501(c)(3) are in *pari materia*—both Subsections are *exceptions* to the three year statute of limitations of Subsection 6501(a) of the Code.

> "Our Constitution is in actual operation; everything appears to promise that it will last; but in this world nothing is certain but death and taxes."
>
> Benjamin Franklin[1]

Ben Franklin notwithstanding, the Government would have this Court hold that only death is a certainty. The Government submits that once a taxpayer has filed a false or fraudulent tax return it has the statutory authority to indefinitely suspend the assessment and collection of taxes even if that suspension extends beyond the life of the taxpayer[2]; and that neither the filing of a proper amended return nor any other act by the taxpayer, no matter what the circumstances, can place any time limitation on this asserted governmental prerogative to assess the tax on a date of its choosing. Congress certainly did not intend the result urged by the Government.

When Congress adopted the Revenue Act of 1918, it provided that:

> "Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made . . . In the case of false or fraudulent returns, the amount of tax due may be determined at any time after the re-

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[1] Benjamin Franklin in a letter to M. Leray—(1789) Bartlett's Familiar Quotations, 15th ed. (1980).

[2] See Petitioner's Br. p. 23.

> turn is filed, and the tax may be collected at any time after it becomes due." Revenue Act of 1918, ch. 18 § 250(d), 40 Stat. 1083.

It is clear from the express language of this statute that Congress intended to create an *exception* to its general statute of limitations in the case where fraudulent returns were filed. The use of the phrase "at any time" did not create an open ended statute of limitations but emphasized the fact that an *exception* was being made for a fraud case. By the Revenue Act of 1921, Congress extended the *exception* to the statute of limitations to encompass the situation where the taxpayer failed to file any return at all. Thus, the Revenue Act of 1921 provided:

> "[I]n the case of a false or fraudulent return with intent to evade tax, *or* of a failure to file a required return, the amount of tax due may be determined . . . at any time after it becomes due. . . ." (Emphasis added). Revenue Act of 1921, ch. 136, § 250(d), 42 Stat. 265.

This Congressional legislation has remained without substantive change through the Internal Revenue Code of 1954 and the amendments thereto.

Although there is no legislative history which expressly sets forth the specific intent of Congress with respect to the enactment of the aforesaid provisions, Petitioner submits that when considered in conjunction with the accepted proposition that the American system of taxation depends primarily upon self-assessment by a taxpayer in informing the Government of his own tax liability (See, Mertens' Law of Federal Income Taxation, § 49.02), Congress' intent becomes quite apparent. Simply put, when the taxpayer files a "return", be it amended or original, which "evinces an honest and genuine attempt to satisfy the law" *Zellerbach Paper Co.* v. *Helvering*, 293 U.S. 172, 180 (1934), Congress initially mandated that the Gov-

ernment shall have five years in which to assess any tax due. Revenue Act of 1918, ch. 18, § 250(d). Congress has shortened that period to the present three year period of limitation of Subsection 6501(a) of the Code.[3] Thus, Congress expressly determined that when the taxpayer has given the Government complete information as to his income, deductions and credits, three years is ample time for the Government to make its determination as to any additional tax which may be due. Subsection 6501(a) of the Code. When the taxpayer fails to provide the Government with such information, then the three year limitation period imposed upon the Government does not begin to run.

The rationale for this distinction is apparent on its face. When the taxpayer files a false return, there is nothing about the return which sets it apart from the thousands of other tax returns which the Government receives which would lead the Government to believe that it is false and that the information contained therein is incomplete or erroneous. Therefore, when the taxpayer has not given the Government the complete and accurate information which the Government requires in order to determine the appropriate tax due, it would be unreasonable to subject the Government to any time constraints with respect to the assessment of additional taxes. Thus, Congress created and retained the exception to the general statute of limitations. Subsection 6501(c)(1) of the Code.

Likewise, in the case of a non-filer (particularly in 1921, before the advent of the computer age), the Government is also hampered, absent any tax return, in its ability to determine the amount of tax which may be owed. Consequently, in the case of a non-filer, as in the case of the filing of a fraudulent return, the Government is, by reason of the exception created by Congress, not subject to the general three year period of limitation. Subsection 6501 (c)(3) of the Code.

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[3] The term "Code", unless otherwise indicated, is a reference to the Internal Revenue Code of 1954, as amended.

In both instances, it is the acts of the taxpayer that have placed the Government at a substantial disadvantage with respect to the determination and imposition of taxes, and it is only reasonable that Congress should see fit to deprive that taxpayer of the benefits of the three year limitation period. On the other hand, when the taxpayer has supplied the Government with complete and proper information as to his income, deductions and credits, reason and logic dictate that the Government must now proceed in accordance with Congressional mandate and seek to assess and collect any tax due within three years of the date of its receipt of required information—whether such information is supplied either by way of an "amended return" or by a "delinquent return". In *Bennett* v. *Commissioner*, 30 T.C. 114 (1958), acq., 1958-2 C.B. 3; Rev. Rul. 79-178, 1979-1 C.B. 435, the Tax Court, construing the provision of Subsection 6501(c)(3) of the Code, so held. In the words of the Court:

> "For, once a nonfraudulent return is filed, putting the Commissioner on notice of a taxpayer's receipts and deductions, there can be no policy in favor of permitting assessment thereafter at any time without limitation. We think that the statute of limitations begins to run with the filing of such returns." 30 T.C. at 123-13.

Petitioners submit that, if this Court accepts the view of both the Tenth and the Third Circuit Courts of Appeals that Subsection 6501(c)(1) and Subsection 6501(c)(3) are in *pari materia*, the Tax Court's holding in *Bennett*, although not binding precedent of this Court, should be viewed as dispositive of the issues. The Court in *Bennett* held that the three year statute of limitations set forth in Subsection 6501(a) is applicable in a case where a taxpayer fraudulently and with intent to evade the tax failed to file a tax return, and where after being the subject of a Government investigation the taxpayer subsequently filed a return. It is illogical and unreasonable to hold that a taxpayer who fraudulently fails to file a

return, and who subsequently files a proper return is entitled to the benefit of the three year statute of limitations, but a taxpayer who files a fraudulent return, and who subsequently files a proper amended return is not[4]. There can be no justification for favoring one errant taxpayer who has failed to meet his obligation over another, or for providing that the consequence of one form of noncompliance can be limited by supplying the Government with accurate information as to income, deductions and credits, while the consequences of a different failure to comply cannot be so limited.

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[4] After stating that is not relevant to the issue before this Court, the Government questions Petitioner's statement that the filing of its amended return was done "voluntarily and without any coercion from the Government whatsoever" (G. Br., p. 4 n. 4). It does so by reference to a clearly self-serving report prepared by an IRS agent in 1977 referring to events which occurred four years prior to the date of the report. Defendant's Answer to Plaintiff's First Set of Interrogatories, Ex 1, Appendix A p. 1a *et seq.* The portions of the report referred to by the Government relate to statements allegedly made by counsel for Petitioner at a meeting at which the author of the report was not present, nor is the source of the agent's knowledge disclosed. Not only is the report inaccurate but its probative value is questionable. It should be noted, however, that the report does show that Martin Windell—who was not an officer of the Petitioner at the time that the amended returns were filed—was the moving force behind the alleged acts of tax fraud (See Appendix A, p. 5a), and that the corporation and its other officers were at best guilty of negligence but not of criminal fraud (Appendix A, p. 5a). The report does make it clear that there was no Government investigation or other activities relating to affairs of the Petitioner prior to the time it filed its amended return (Appendix A, p. 2a). The Petitioner was not subject to "any coercion from the Government whatsoever" and as between the Petitioner and the Government, the filing of an amended tax return was clearly a "voluntary" act on the part of the Petitioner. (Although the report is referred to at length by the Government, it did not request its inclusion in the Joint Appendix nor see fit to include the document as part of the Appendix to its Brief. Petitioner has included the relevant portions thereof as Appendix A.)

In its Brief, the Government never squarely addresses the *Bennett* decision nor the implication of that decision on the issues presented herein. Rather, it erroneously contends that "[N]othing in the legislative materials suggests that Congress intended the two provisions to operate in identical fashion. And the language Congress used clearly indicates that it did not". (G. Br. 34, n. 26). This statement overlooks the fact that Congress in the 1921 Code, addressing itself for the first time to the question of failure to file, enacted the provision relating to failure to file within the same sentence as that dealing with the filing of a false return (Revenue Act of 1921, ch. 136 § 250(d), 42 Stat. 265). All subsequent enactments followed the same pattern until the 1954 Code, when the provisions were separated into two sentences in the same section of the Code. This change was made without substantive comment by Congress. Petitioner suggests that there can be no greater showing of Congress' intent that both subjects be dealt with in the same manner.

The *Bennett* decision and the Government's own Revenue Ruling (Rev. Rul. 79-178, 1979-1 C.B. 435) belie its present contention that fraudulent non-filers who subsequently file what the Government describes as "delinquent returns" do not receive preferential treatment above that afforded the taxpayer who files a fraudulent return and subsequently files a complete and accurate "amended return". The *Bennett* taxpayer was indisputedly engaged in the perpetration of tax fraud. He was not a taxpayer, as the Government's brief suggests, who innocently or negligently failed to file a return on its due date and subsequently voluntarily filed a "delinquent return". (G. Br. p. 35). The Government's Revenue Ruling which followed the holding in *Bennett* states that it was directed toward the following issue:

> "Can tax be assessed at any time under section 6501 (c)(1), (2) or (3) of the Internal Revenue Code in a case where the taxpayer did not timely file an income tax return in a ***willful attempt to evade*** income

> tax but, after an Internal Revenue Service investigation began, filed a correct, but delinquent, return?" (Emphasis added)

The Government concluded after some analysis that:

> "The tax cannot be assessed at any time under section 6501(c) of the Code, but must be assessed within the three-year period of limitations provided in section 6501(a) (June 1, 1979). 26 CFR 301.6501 (c)-1: Exceptions to general period of limitations on assessment and collection". Rev. Rul. 79-178, 1979-1C.B. 435.

Notwithstanding the foregoing, the Government, without providing any logical explanation or distinction, now urges a contrary holding with respect to a taxpayer who purportedly sought to evade the payment of taxes by filing a fraudulent return and who subsequently filed an accurate amended return. The Government in its Brief denies that its positions are inconsistent. But the mere stating of the Government's contention is to expose the illogical and unreasonable nature of that position. The Government's position is predicated not on the issue of taxpayer's "intent to defraud", but rather on the manner in which the taxpayer sought to carry out that intent. It is the Government's contention that if the taxpayer, who intends to defraud the Government, carries out his fraudulent intent by not filing a tax return, he is afforded the benefit of the statute of limitations, provided he files his return *at any time*. If, however, the taxpayer who intends to defraud the Government, carries out his fraudulent intent by filing a false return, he is never afforded the benefit of the statute of limitations, even if he voluntarily files a complete, accurate non-fraudulent amended return. Such a proposition is illogical and inconsistent with the rational statutory scheme enacted by Congress.

POINT II

The construction urged by the Government will invite abuse—preventing the taxpayer from contesting arbitrary disallowances by the Government.

This Court has stated that statutes of limitations are enacted in a sense of fairness to prevent claims from being suspended over a period of time "until evidence has been lost, memories have faded and witnesses have disappeared". *Burnett v. New York Central R. Co.*, 380 U.S. 424, 428 (1965). The policy arguments urged by the Government run contrary to this generally accepted principle.

When, on August 9, 1973 the Petitioner herein filed its amended returns for the taxable years 1967 and 1968, it paid the tax due as reflected on the returns. These returns are conceded by the Government to be non-fraudulent amended returns. With respect to such returns, the Government, in addition to assessing a fraud penalty under Code Subsection 6653(b), also seeks to collect additional taxes based on the Government's resulting disallowance of certain deductions claimed by the Petitioner. (JA 71A; G. Br. 4; A. 5a). While the burden of proving that the initial returns filed in 1967 and 1968 were fraudulent may rest with the Government, once the amended returns were filed and the Government disallowed certain of the deductions claimed on these returns, the burden of proving the propriety of these deductions lies not with the Government but with the Petitioner. *Richard P. Rosenberg* v. *Commissioner*, (Dec. 32,417 (M)), 33 T.C.M. (CCH) 31 (1974), aff'd., 519 F.2d 1400 (4th Cir. 1975); *Mike M. and Helen Grancich* v. *Commissioner*, (Dec. 35,026 (M)), 37 T.C.M. (CCH) 424 (1978), aff'd., unpublished opinion 4-30-81 (9th Cir. 1981); *Thelma Blevins* v. *Commissioner*, (Dec. 21,157 (M)), 14 T.C.M. (CCH) 840 (1955), aff'd., 238 F.2d 621 (6th Cir. 1955). In December, 1979, the Government, having reviewed the complete and fully informative amended returns filed by the Petitioner in 1973, disallowed certain deductions which relate solely to the business operations of the Petitioner. It is now the Pe-

titioner's burden to establish and prove the propriety of those deductions. By reason of the Government's unjust delay in seeking to assess and collect additional taxes from Petitioner, Petitioner will be required, more than ten years after the filing of its amended returns, to present evidence (*which may now be lost*) and witnesses (*whose memories may have faded or have disappeared*) to verify business deductions and expenditures it made in 1967 and 1968.

To place the Petitioner in such a position is contrary to any concept of fairness and creates a fertile breeding ground for Government abuse. If this Court accepts the position urged by the Government that it is free to assess the tax "at any time", a taxpayer could be required to meet its burden of establishing the propriety of its business deductions not 10 years after the filing of an amended return, but, if the Government so chooses, 15 years, 20 years or even 30 years after the date on which the expenses were incurred.

The Government states that "Petitioner's fear that the Government will abuse the unlimited assessment penalty is unrealistic". (G. Br. 27). However, the record in this case demonstrates that Petitioner's fear of Government abuse is not unrealistic, but quite real. There is absolutely no justification for the Government to have waited over six years after Petitioner had filed its amended returns to have made its assessment.[5]

The substantial prejudice to the Petitioner as a result of the Government's inaction is obvious, and cannot be justified by any reference to some vague policy con-

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[5] Petitioner filed its amended return on August 9, 1973. The Government's internal report indicates that the Intelligence Division granted permission to the Civil Division to proceed civilly against the Petitioner in early 1975, even though it recommended criminal proceedings against a former officer of Petitioner, Mr. Martin Windell. Moreover, the report further indicates that the criminal investigation of this former officer was concluded by the IRS on July 26, 1976 (Appendix A, p. 6a).

sideration. Once a taxpayer has filed an amended return and has given the Government all of the information that the Government needs to assess the tax, by Congressional mandate the Government must take affirmative action within three years of the filing of that return. Subsection 6501(a) of the Code. To remove the time restraints which Congress placed on the Government in which it must move to assess the tax is not only unreasonable but is also highly prejudicial to the taxpayer and contrary to the general principles of statutes of limitations.

Were this Court to accept the proposition urged by the Government—that it has an open ended time frame in which to assess taxes and determine deficiencies—it would place a burden on a taxpayer that could not possibly be met. For unless the taxpayer can find some way of preserving evidence forever; freezing and maintaining the memories of those persons having knowledge of the relevant facts; and providing for the immortality of his accountants and others whose testimony would be vital to establishing the propriety of any business deductions he has claimed—such a task is impossible for any taxpayer—the taxpayer must concede any disallowance which the Government chooses to make. Therefore, granting the Government the power to delay the assessment of tax until it and it alone decides to act would also grant the Government the power to act with impunity with respect to the disallowance of any deduction claimed by the taxpayer.

The continuing passage of time diminishes the taxpayer's ability to dispute any disallowance made by the Government. Thus, the longer the Government delays in acting to assess the taxes it claims are due, the less the taxpayer, who bears the legal burden of proving his deduction, is able to sustain that burden! To place such power in the hands of the taxing authority gives it ability to pressure the taxpayer to settle all pending and collateral disputes, irrespective of the merits of the

taxpayer's opposition. This certainly cannot be an acceptable rule of law in a tax system based on the precepts of voluntary disclosure, fairness and the assertion and prosecution of viable defenses; nor does the bridling of this potential abuse of power restrain or undermine the efficacy of the federal tax system.

POINT III

The need to foster voluntary self-reporting and re-evaluation of tax returns outweighs the Government's policy arguments.

The Government contends that there are sound policy and practical considerations in the case of the filing of a fraudulent tax return which warrant its having an unlimited period of time in which to assess any additional tax, notwithstanding filing by the taxpayer of an amended tax return.

The first of these considerations set forth in the Government's Brief is that fraud cases are ordinarily more difficult to investigate than routine tax cases and that the filing of an "amended return" does not "substantially diminish the amount of effort required to verify the correct tax liability". (G. Br. 21). While recognizing the Government's contention that tax fraud cases may be more difficult to investigate, Petitioner submits that the filing of an "amended tax return" is of substantial value to the Government, for not only does the filing of an amended return aid the Government in proving its case of fraud, but it also lessens the number of hours necessary for the Government to verify the information provided. By comparing a correct and complete amended tax return with the original fraudulent return, the Government can easily focus on those areas of the taxpayer's activities in which a fraud has been perpetrated, thereby narrowing the scope of its investigation and

contracting the number of hours in investigative work required to gain the evidence the Government will need to meet its burden of proof.

Secondly, the Government contends that the filing of the amended return "does not fundamentally change the nature of a tax fraud investigation. Amended returns, however accurate they may ultimately prove to be, come with no greater guarantee of trustworthiness than other submissions". (G. Br. 21). If by this statement the Government implies that the filing of an "amended return" may of itself be of little value because it may be false and fraudulent, such a contention, even if true, is not germane to the issue before this Court. If the amended return proves to be false and fraudulent in any respect, then the exception to the statute of limitations (Code Subsection 6501(c)(1)) remains operative and the Government is not under any time restraint with respect to assessing any tax which may be due. It is only when the taxpayer has filed a non-fraudulent amended tax return that the three year statute of limitations begins to run. If the Government is suggesting that it needs more than three years to verify the correctness of the information set forth in the amended return, Petitioner submits that Congress has seen fit to deny the Government such a luxury. Congress has expressly limited the Government to a three year period in which to determine the accuracy and propriety of non-fraudulent tax returns and the assessment of the tax due thereunder. Code Subsection 6501(a). There can be no justification for the Government's claim that it needs more time to verify the information contained in an amended return than it needs to verify information contained in an original return. The verification procedure should be the same and both are subject to the Congressional mandate that the process be completed within three years of the filing of the return.

Another policy consideration which the Government alludes to in its brief is the fact that, unlike other civil tax cases, in a false filing case the burden of proof with re-

spect to the issue of fraud rests with the Government[6]. In this regard, the Government states that while the amended return "may constitute an admission of substantial underpayment, it will not ordinarily constitute an admission of fraud". (G. Br. p. 22). Armed with an admission by the taxpayer that it has substantially understated its income, the Government is certainly in a much better position of meeting its burden of proof on the question of fraud than it otherwise would have been in the absence of such an admission. Moreover, the Government's unsupported contention that "[O]nce a criminal referral has been made, the Commissioner will often find it difficult, if not impossible, to complete his civil investigation within the normal three-year period, and the taxpayer's filing of an amended return will not make any difference in this respect" (G. Br. p. 23) is simply unrealistic. This statement presupposes that the amended return has been filed at the time of or prior to the referral of the matter to the Criminal Division, which may or may not be the case. Further, it ignores the fact that prior to the referral to the Criminal Division the Government must have uncovered at least what it perceives to be a *prima facie* case of tax fraud so as to warrant such a referral. Moreover, at the time that the Government's Criminal Division seeks an indictment of the taxpayer based upon a charge of tax fraud the investigation must have progressed to the point that the Government honestly believes that it has sufficient evidence to establish the taxpayer's guilt "beyond a reasonable doubt". If this is not the case, the Criminal Division cannot proceed to seek an indictment of the taxpayer, for to do so would be contrary to the high standard of con-

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[6] The same burden of proof rests with the Government in a case of a fraudulent non-filing of a tax return. Yet the Government acquiesced in the decision of *Bennett* v. *Commissioner*, which held that the three year statute of limitations was applicable to a tax return filed subsequent to Government action. Petitioner submits that the Government's prior inconsistent position points up the frivolous nature of this alleged policy argument.

duct imposed upon the Government in cases of criminal prosecution. *Berger* v. *United States*, 295 U.S. 78 (1935). At such time as the Government seeks to indict the taxpayer, it undoubtedly will have completed its criminal investigation. Thus, the Government's claim that if it is required to assess civil tax liabilities within three years of the filing of the amended return it would not have ample time within which to discharge its responsibility to enforce the criminal tax laws, is totally without merit.

This fact is amply demonstrated by an examination of the underlying facts of the cases which have been cited to this Court as being relevant to these issues herein. In *Dowell, Britton, Nesmith,* and *Badaracco,* the Government had more than sufficient time between filing of the amended return and the running of the three year statute of limitations in which to complete its criminal investigation and file its civil Notice of Deficiency[7]. However, it did not choose to act with dispatch.

	Amended Return Filed	*Indictment*	*Statutory Notice of Deficiency Issued*
[7] *Deleet* v. *United States*	8/09/73	NONE*	12/14/79
Badaracco v. *Commissioner*	8/17/71	11/71	12/21/77
Dowell v. *Commissioner* 614 F. 2d 1263, 1264 (10th Cir. 1980)	11/25/68	5/07/70	12/11/74

(*Table continued on following page*)

* Martin Windell, a former officer of Deleet, who had left the company several years prior to the filing by Deleet of the amended returns on 8/9/73, was the subject of a criminal proceeding. The investigation of Mr. Windell's affairs was completed by the IRS on 7/26/76 (Appendix A, p. 6a) and all criminal proceedings were completed in May of 1976. (G. Br., p. 5, n.5).

Petitioner submits that the alleged risks which the Government claims it might incur in pursuing a parallel civil and criminal investigation, as outlined in the Internal Revenue Manual (G. Br. 24), if they in fact exist, are not of such magnitude as to justify the position urged by the Government with respect to the imposition of tax liability. These risks as set forth in the Government's Brief are as follows: (1) possible premature disclosure of evidence to a defendant; (2) claims of harassment by potential criminal defendants; (3) seizure of funds in a civil case that might deny a defendant the criminal attorney of his choice; (4) difficulties with witnesses where the civil trial precedes the criminal trial; and (5) difficulties with the introduction of evidence in a civil case owing to taxpayers' assertion of Fifth Amendment rights.

(1) The Petitioner submits that the possible premature disclosure of evidence to a defendant is no justification for allowing the Government to have an open-ended period in which to proceed civilly with respect to the imposition of civil tax liability. The prejudice to the taxpayer by such a policy clearly outweighs any concern the Government might have with respect to disclosure of evidence. This is particularly true since the Government has the ability to seek protection of the courts

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(Footnote continued from preceding page)

	Amended Return Filed	*Indictment*	*Statutory Notice of Deficiency Issued*
Britton v. *United States* 532 F. Supp. 275, 276 (D. Vt. 1981)	2/06/76	3/15/78	3/19/79
Nesmith v. *Commissioner* 699 F. 2d 712 (1983)	12/73	Criminal Investigation Commenced 1973	12/01/78

to prevent such premature disclosure. *Campbell* v. *Eastland*, 307 F. 2d 478 (5th Cir. 1962).

(2) The claim that parallel investigations might harass potential criminal defendants is unrealistic. Whether the investigation is being conducted on the criminal or civil side neither adds to nor decreases the likelihood of harassment of potential defendants. Moreover, if the Government conducts its investigation in accordance with accepted modes of conduct, there is no danger of it harassing potential parties.

(3) A concern that the seizure of funds in a civil case may deny a criminal defendant an attorney of its choice is easily resolved by the Government's own action. The Government is not obligated, when it files a civil tax deficiency notice, to seize the taxpayer's funds and, if this were truly a concern, the Government can easily proceed on an *ad hoc* basis and exercise restraint when appropriate. To use such an argument to support an open-ended statute of limitations is completely inappropriate.

(4) The concern the Government voices with respect to its difficulty with witnesses in situations where civil cases precede criminal cases may be a real one. But, a taxpayer's and/or a defendant's entitlement to an early resolution of any claim brought against him by the Government, whether that claim is lodged on either the civil or criminal docket, certainly outweighs this concern.

(5) Lastly, the Government claims the difficulty that it may encounter in a civil prosecution where the taxpayer has asserted the Fifth Amendment privilege. Since in a civil case, the Government is entitled to the benefit of a most favorable inference by reason of the taxpayer's assertion of the Fifth Amendment privilege (*Baxter* v. *Palmigiano*, 425 U.S. 308 (1976); *Winterland Concessions Co.* v. *Sileo*, 528 F.Supp. 1201 (N.D. Ill. 1981); *Poplar Grove Pltg. & Ref.* v. *Bache Halsey Stuart Inc.*,

465 F.Supp. 585 (M.D. La.), cause remanded, 600 F.2d 1189 (5th Cir. 1979), it is not prejudiced by assertion of a constitutionally protected right. The Government cannot honestly aver that the possible assertion of that privilege justifies its claim of need to permit an open-ended period of time to assert civil claims against a taxpayer, irrespective of the filing of an amended return.

As an additional policy consideration, the Government refers to Subsection 6501(e)(1)(A) of the Code, contending that a person who filed an alleged fraudulent return and subsequently files a corrected amended return should not be placed in a better position than the taxpayer who made substantial but non-fraudulent omissions on his original return. In making this argument, the Government does not address itself to the distinctions raised by Petitioner in its initial brief. (See, Petitioner Br., p. 41, *et seq.*) Essentially, the Government never addresses the proposition that unlike Code Subsection 6501(c)(1), Subsection 6501(e)(1)(A) is not an exception to the general three year statute of limitations contained in Subsection 6501(a) but is rather a self-contained substituted six year statute of limitations, having no relationship to either Subsection 6501(a) or 6501(c). *Klemp* v. *Commissioner*, 77 T.C. 201, 206. Thus, Petitioner submits that the decisions in *Goldring* v. *Commissioner*, 20 T.C. 79 (1953) and *Houston* v. *Commissioner*, 38 T.C. 486 (1962) are not inconsistent with the interpretation of Subsections 6501(c)(1) and (c)(3) which Petitioner puts forth. *Goldring* and *Houston* stand for the proposition that the filing of an amended return does not "relate back" to the original return so as to shorten the Congressionally enacted limitations period of Subsection 6501(e)(1)(A). Petitioner, accepting the proposition that the filing of an amended return would not shorten any limitation period with respect to Subsection 6501(c), submits that the filing of the amended return starts the limitation period enacted by Congress in Subsection 6501(a), to wit, a three-year statute.

The Government's contention that persons who file an allegedly fraudulent return will be placed in a "better" position than those who made substantial but non-fraudulent omissions on their returns ignores the realities of the situation. Extremely drastic penalties may be visited upon a taxpayer who files a fraudulent return or fraudulently fails to file. This is not the case with respect to a Subsection 6501(e)(1)(A) taxpayer. As already noted, the taxpayer who omits 25% of income from his return does have the benefit of a statute of limitations which begins to run the day his return is filed. The taxpayer whose return is subject to Subsection 6501(c)(1) receives no such benefit. It is only when such a taxpayer files an honest and complete amended return that he is to receive the limited benefit of that three year period of limitation provided for in Subsection 6501(a). Moreover, the filing of the amended return does not insulate the taxpayer from the possibility of criminal prosecution nor does it protect the taxpayer from the imposition of the 50% civil fraud penalty. Indeed, the very act of filing amended returns has probably heightened such possibilities.

In sum, the Government's alleged policy considerations are without substance. Furthermore, they must yield to a more basic overriding consideration—the United States tax system is dependent upon *voluntary self-assessment* by its taxpayers and relies on the good faith of each taxpayer to disclose honestly all information relevant to his tax liabilities. *United States* v. *Bisceglia*, 420 U.S. 141, 145 (1975); *Lucia* v. *United States*, 474 F. 2d 565 (5th Cir. 1973). Thus, no policy should be enunciated which deters self-assessment or which punishes a taxpayer, who, like the Petitioner, reexamines his prior act and comes forth and discloses by way of an amended return the information relevant to his tax liability. Neither should a policy be enunciated which places a premium on silence—do not file an amended return, elect to gamble on non-detection—for nothing is to be gained and much is to be lost by the admissions made by way of filing of an amended return.

Congress has adequately provided the most severe sanctions to penalize those taxpayers who initially disregard their duty of self-assessment. Criminal penalties and the 50% civil fraud penalty are adequate to protect the Government's interests. There is no need to assent to the Government's desire to impose penalty upon penalty and condemn the taxpayer to eternal purgatory, where no act of penitence can end the fires of uncertainty, and the Government, unbridled and unrestrained, can dictate the taxpayer's day of judgment. Certainly, such a result cannot be said to have been intended by Congress.

CONCLUSION

Petitioner submits that for the reasons hereinabove stated the filing of an honest amended tax return commences the running of the statute of limitations provided in Subsection 6501(a). Therefore, the decision of the United States Court of Appeals for the Third Circuit should be reversed and the judgment of the United States District Court for the District of New Jersey in favor of the Petitioner should be reinstated and affirmed.

Respectfully submitted,

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Attorney for Petitioner in Docket No. 82-1509

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[APPENDIX FOLLOWS]

APPENDIX A

Report Transmittal

Total Hours:

264

Name and address of taxpayer:

Deleet Merchandising Corp.
26 Blanchard Street
Newark, N.J. 07105

Related cases or key case:

Graphic Enterprises, Inc.
William and Beatrice Abrams
Martin Windell
Elliot and Evelyn Liroff
Joseph and Barbara Durfel
Richard and Harriet Liroff
Harvey and Minna Kramer

Return form No.:

1120

Years or periods:

1966 to 1972 Inclusive

Agreement:

None

Other information (Unagreed issues and important information not covered in workpapers or report):

Appendix A

The Intelligence Division initiated an investigation of the above taxpayers, when an attorney, Barry Fredericks appeared at the U.S. Attorney's Office, Newark, N.J. and in the presence of Chief John O'Hara and Group Manager, Charles Rapa of the Intelligence Division, he made the following admissions on 1/30/73:

(1) The taxpayers and clients listed above had been skimming receipts and funds for years.

(2) He was making what he felt was a voluntary disclosure and was in the processing of preparing and filing amended returns.

The Intelligence Division advised him that the I.R.S. no longer had a voluntary disclosure policy, that all information furnished would have to be investigated and finally they could not guarantee that his clients would escape prosecution. Mr. Fredericks further stated that one of the individuals not identified at this time had attempted to "shake down" or extort $350,000 from the other 5 individuals and threatened that unless his demands were met that he would "blow the whistle" on the others to the IRS about their flagrant evasion scheme.

Examining Officer:

Charles Lazarus—11/02

Date:

1/12/77

Approved by (Signature of reviewer):

Thomas Pienno, 2/14/77

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Appendix A

On 2/13/73, Fredericks called the Intelligence Division to notify them that he had filed some corporate returns and that the name of the individual whom he identified as the extortionist was Martin Windell.

* * *

Fredericks made numerous allegations about Martin Windell such as the motivation for his alleged extortion, namely to finance his drug habits, high life style, expenses of being a paramor etc. He stated that the Corporations had opened diversionary bank accounts where unreported corporate receipts were deposited and where funds were disbursed to all of the officers. The accountant stated that amended returns were being prepared for all of the entities involved.

* * *

Audit uncovered that amended returns were filed on 2/12/73 with the following adjustments to taxable income:

Debit Commissions Expense—paid to officers.

Credit Gross Receipts for the same amounts.

In effect the first amended return did not increase or decrease taxable income. Examination further disclosed that re-amended corporate returns were filed on 8/9/73, which basically resulted in the following adjustments to taxable income:

Accounts Receivable and Accounts Payable were debited or credited and

Profit and loss items such as gross receipts and purchases were either debited or credited.

Appendix A

Thus, the taxable income of the years 1966 to 1971 inclusive which culminated with the filing of amended and re-amended returns increased or decreased taxable income as disclosed on the Forms 1120.

• • •

R. Mirsky CPA had replaced F. Geller CPA as the co-representative with B. Fredericks. Audit uncovered the following specific issues:

1. Commissions expense—deducted on all of the amended returns. Examination showed that payments were made to the officers in the various years as follows:

a. Checks disbursed directly from the diversionary, secret unrecorded bank accounts.

b. Proceeds of corporate customers' notes collected and deposited in officers' personal checking accounts. These amounts were reported as gross receipts on the amended returns.

c. Personal checks issued by the officers to one another allocating the fruits of some of the unreported income.

The taxpayer claimed through their representatives that the amounts of commissions distributed to the various officers were determined by a complicated formula consisting of 7 pages. No evidence was submitted to substantiate that this formula was in existence back in 1966.

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Appendix A

The representative would not agree to the fraud penalty for the following reasons:

1. Martin Windell's involvement was separate and distinct from the other individuals and corporations. He was guilty of fraud while their clients were guilty of negligence at best.

2. They feel that their clients made a true voluntary disclosure for both civil and criminal purposes.

3. They would agree to the negligence penalty on open years.

• • •

Deleet Merchandising Corp. Years 1966 to 1972 inclusive

The following additional items were adjusted in the years 1970 to 1972 inclusive. The representative stated verbally that although he agreed with these adjustments, he would not sign a partial agreement in order to expedite the closing of the entire case:

(1) Travel and entertainment—1970 to 1972 inclusive. Cash items totalling about $30,000 each year were only substantiated to the amounts listed on unsworn statements on Deleet letterheads.

(2) Purchases—1970 to 1972 inclusive. Purchases included payments to employees which actually represented nondeductible loans which were never repaid. This account also included capital items which were expensed erroneously.

(3) Building repairs—1970 to 1972 inclusive. Audit uncovered also additional capital items which

had been deducted and is being adjusted accordingly.

(4) Gross receipts—1970 only. Examination of one of the diversionary bank accounts Chase Manhattan showed deposits not reported on either the original amended or re-amended returns.

Examination of the years 1966 to 1969 were confined to the fraud issuer, namely civil fraud penalty and commissions deducted determined to be non-deductible corporate distributions taxable as dividends to the recipient officer stockholders.

Inventories did not fluctuate over the years and were accepted as reported on the returns. Submission of the case for civil closing was delayed for numerous reasons as follows:

(1) Permission was granted by Intelligence Division to proceed civilly early in 1975 even though they had recommended criminal prosecution against Martin Windell.

(2) Fraud referral was rejected by Intelligence Division on 10/2/75. Immediately thereafter, permission was requested from Assistant Regional Council, Criminal Tax Philadelphia to proceed civilly against Deleet even though issues discussed would relate to the criminal items against Martin Windell. In their memorandum dated 1/15/76, they requested that civil closing be suspended temporarily.

(3) The closing memorandum on Martin Windell was returned to the Audit Division on or about 7/26/76. The case was returned shortly thereafter by the Review Staff to this examiner.

Appendix A

It is to be noted that a certified transcript has been secured as of 10/11/76 and that for the purposes of this report the taxpayer was only allowed amounts assessed even though amended returns were filed which increased the tax liabilities reported on the various returns.